Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	CC Docket No. 96-45
Federal-State Joint Board on	)	
Universal Service	)	

ORDER ON REMAND, FURTHER NOTICE OF PROPOSED RULEMAKING, AND MEMORANDUM OPINION AND ORDER

Adopted: October 16, 2003 **Released: October 27, 2003**

Comment Date: **30 days after publication in the Federal Register**
Reply Comment Date: **60 days after publication in the Federal Register**

By the Commission: Chairman Powell, Commissioners Abernathy, Copps and Adelstein issuing separate statements; Commissioner Martin approving in part, dissenting in part, and issuing a separate statement.

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I. INTRODUCTION

1. In this Order, in response to the decision of the United States Court of Appeals for the Tenth Circuit and the recommendations of the Federal-State Joint Board on Universal Service (Joint Board), we modify the high-cost universal service support mechanism for non-rural carriers and adopt measures to induce states to ensure reasonable comparability of rural and urban rates in areas served by non-rural carriers.[1] We will continue to determine non-rural support by comparing statewide average costs to a national cost benchmark, but we establish a

[1] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432 (1999) (*Ninth Report and Order*), *remanded, Qwest Corp v FCC*, 258 F.3d 1191 (10th Cir. 2001) (*Qwest*); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision,17 FCC Rcd 20716 (2002) (*Recommended Decision*). The term "non-rural carriers" refers to incumbent local exchange carriers that do not meet the statutory definition of a rural telephone company. *See* 47 U S.C § 153(37). Under this definition, rural telephone companies are incumbent carriers that either serve study areas with fewer than 100,000 access lines or meet one of three alternative criteria. *Id* Thus, "non-rural carriers" are principally defined by study area size. Non-rural carriers serve the majority of access lines nationwide, including lines in rural, insular, and high-cost areas. Rural carriers serve fewer than twelve percent of lines nationwide, and their operations tend to be focused in high-cost areas. "Non-rural support" refers to high-cost universal service support for non-rural carriers.

new cost benchmark at two standard deviations above the national average cost. Our action today ties the cost benchmark more closely to the data in the record, consistent with the court's directive, but does not substantially alter the level of non-rural support. Based on analysis of the relevant data, we explain why the modified non-rural mechanism will be sufficient to achieve the statutory principle of making rural and urban rates for non-rural carrier customers reasonably comparable.

2. In addition, we will implement a rate review, through an expanded annual certification process, to induce states to achieve reasonably comparable rates and to assess how successfully the non-rural high-cost support mechanism ensures reasonably comparable rural and urban rates. Consistent with the Joint Board recommendation, states will be required to certify that the basic service rates in their rural, high-cost areas served by non-rural carriers are reasonably comparable to a national urban rate benchmark or explain why they are not.[2] This process will add a dynamic element to the non-rural high-cost support mechanism.[3] By requiring states to review their rates in rural, high-cost areas served by non-rural carriers annually in comparison to a national urban rate benchmark, the Commission will be able to determine whether federal and state universal service mechanisms are resulting in reasonably comparable rural and urban rates as competition develops and erodes implicit support mechanisms.

3. In the attached Further Notice of Proposed Rulemaking, we seek comment to further develop the record on specific issues that relate to the rate review and expanded state certification process recommended by the Joint Board. We also seek comment on a proposal to further encourage states to preserve and advance universal service by making available additional targeted federal support for high-cost wire centers in states that implement explicit universal service mechanisms.

II. EXECUTIVE SUMMARY

4. In this Order, we take the following actions to modify the non-rural high-cost support mechanism and to induce states to ensure reasonably comparable rural and urban rates in areas served by non-rural carriers:

- Consistent with the Joint Board's recommendations, we reaffirm that comparing statewide average costs to a nationwide cost benchmark reflects the appropriate federal and state roles in determining federal non-rural high-cost support. We find no evidence

[2] As discussed below, the purposes of the rate and cost benchmarks are different. The cost benchmark is used to determine the amount of high-cost support non-rural carriers in each state will receive, whereas the rate benchmark will be used in determining whether a state's rural rates are reasonably comparable to urban rates nationwide.

[3] *See Federal-State Joint Board on Universal Service, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, Report and Order in CC Docket No. 00-256, 16 FCC Rcd 11244, 11249, para. 11 (2001) (*Rural Task Force Order*) (recognizing that "[o]ur universal service rules cannot remain static in a dynamic marketplace.").

in the record either for radically altering the current non-rural mechanism or for establishing a substantially larger federal subsidy to lower local telephone service rates, as some commenters advocate.

- In response to the Tenth Circuit's remand, we define the relevant statutory terms "sufficient" and "reasonably comparable" more precisely for purposes of the non-rural mechanism. As recommended by the Joint Board, we define "sufficient" in terms of the statutory principle in section 254(b)(3), as enough federal support to enable states to achieve reasonable comparability of rural and urban rates in high-cost areas served by non-rural carriers. We also agree with the Joint Board that the principle of sufficiency means that non-rural support should be only as large as necessary to achieve the statutory goal. We define "reasonably comparable" in terms of a national urban rate benchmark recommended by the Joint Board. As part of the rate review process discussed below, the rate benchmark will be used in determining whether a state's local rates in rural, high-cost areas served by non-rural carriers are reasonably comparable to urban rates nationwide.

- We modify the non-rural mechanism by basing the cost benchmark, which is used to determine the amount of non-rural high-cost support, on two standard deviations above the national average cost per line. Modifying the cost benchmark ties it more directly to the relevant data, consistent with the court's directive, but does not alter the level of non-rural support in a major way. We agree with the Joint Board that the current level of non-rural support is supported by data from a General Accounting Office (GAO) Report indicating that rural and urban rates generally are reasonably comparable today.

- To induce states to achieve reasonably comparable rates, we adopt with minor changes the rate review and expanded certification process recommended by the Joint Board. Each state will be required to review its rates in rural, high-cost areas served by non-rural carriers annually to assess their comparability to urban rates nationwide, and then to file a certification with the Commission stating whether its rural rates are reasonably comparable to urban rates nationwide or explaining why they are not.

- For purposes of the rate review process, we adopt the Joint Board's recommendation that we establish an annually-adjusted nationwide rate benchmark based on the most recent urban residential rates in the *Reference Book*, the Wireline Competition Bureau's annual rate survey. Specifically, we adopt a rate benchmark of two standard deviations above the average urban rate, which, based on the most recent *Reference Book* survey, is $32.28 or 138 percent of the average urban rate. The rate benchmark will establish a "safe harbor," that is, a presumption that rates in rural, high-cost areas that are below the rate benchmark are reasonably comparable to urban rates nationwide. States with rural rates below the rate benchmark may certify that their rates are reasonably comparable without providing additional information, or rebut the presumption by demonstrating that factors other than basic service rates affect the comparability of their rates.

- For purposes of the rate review process, we also establish a basic service rate template for states to use in comparing rates in rural, high-cost areas served by non-rural carriers to

the nationwide urban rate benchmark. In addition, we adopt, with slight modifications, the definition of "rural area" already contained in section 54.5 of the Commission's rules for purposes of the rate review process.

- We adopt the Joint Board's recommendation to permit states to request further federal action, if necessary, based on a demonstration that the state's rates in rural, high-cost areas served by non-rural carriers are not reasonably comparable to urban rates nationwide and that the state has taken all reasonable steps to achieve reasonable comparability through state action and existing federal support.

- In response to the Tenth Circuit's remand, we review and explain our comprehensive plan for supporting universal service in high-cost areas.

- In the attached Further Notice, we seek comment on issues related to the rate review and expanded certification process. In particular, we propose a method for calculating any additional targeted federal support that may be provided in response to a state request for further federal action, based on forward-looking cost estimates. Under this proposal, any such support would be targeted on a wire-center basis, based on a set percentage of per-line costs exceeding a threshold above the national average cost for wire centers.

- We also seek comment in the attached Further Notice on whether we should make additional targeted federal support available for high-cost wire centers in states that implement explicit universal service mechanisms, without regard to their achievement of rate comparability, in order to encourage states to adopt universal service mechanisms that will be sustainable in a competitive environment.

III. BACKGROUND

A. The Act

5. The Telecommunications Act of 1996 Act codified the historical commitment of the Commission and state regulators to promote universal service by ensuring that consumers in all regions of the nation have access to affordable, quality telecommunications services.[4] In section 254 of the Act, Congress directed the Commission, after consultation with the Joint Board, to establish specific, predictable, and sufficient support mechanisms to preserve and advance universal service, based on several enumerated principles.[5] Among other things, section 254(b) provides that consumers in rural, insular, and high-cost areas should have access to telecommunications services at rates that are "reasonably comparable to rates charged for similar

[4] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act). The 1996 Act amended the Communications Act of 1934. 47 U.S.C. §§ 151, *et seq.* (Communications Act or Act). References to section 254 in this Order and Further Notice of Proposed Rulemaking refer to the universal service provisions of the 1996 Act, which are codified at 47 U.S C. § 254 of the Act. 47 U S.C. § 254; *see also* 47 U.S.C. § 214(e).

[5] 47 U S.C. § 254. *See also Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Notice of Proposed Rulemaking and Order Establishing Joint Board, 11 FCC Rcd 18092 (1996).

services in urban areas."[6] In addition, section 254(e) provides that federal universal service support "should be explicit and sufficient to achieve the purposes of this section."[7]

B. Ninth Report and Order

6. Consistent with the Act, the Commission has taken major steps over the last seven years to put in place explicit federal universal service support mechanisms that will be resilient as competition develops over time.[8] In one of these major steps, in the *Ninth* and *Tenth Report and Orders*, the Commission established a new federal high-cost universal service support mechanism for non-rural carriers based on forward-looking economic costs.[9] The non-rural mechanism determines the amount of federal support to be provided to non-rural carriers in each state by comparing the statewide average cost per line, as estimated by the Commission's cost model, to a nationwide cost benchmark of 135 percent of the national average cost.[10] Federal support is provided to non-rural carriers in states with costs that exceed the benchmark.

C. Tenth Circuit Remand

7. In *Qwest*, the Tenth Circuit upheld the Commission's cost model, but remanded the methodology for determining non-rural support adopted in the *Ninth Report and Order*. On remand, the court required the Commission to define more precisely the statutory terms "reasonably comparable" and "sufficient" and then to assess whether the non-rural mechanism will be sufficient to achieve the statutory principle of making rural and urban rates reasonably comparable.[11] In addition, the court found that the Commission failed to explain how its 135 percent nationwide cost benchmark will help achieve the goal of reasonable comparability or sufficiency.[12] The court required the Commission on remand "to develop mechanisms to induce adequate state action."[13] Finally, because the non-rural mechanism concerns only one piece of universal service reform, the court stated that it could not properly assess whether the total level

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[6] 47 U.S.C § 254(b)(3).

[7] 47 U.S.C. § 254(e).

[8] *See infra* part IV.E.

[9] *Ninth Report and Order*, 14 FCC Rcd 20432; *Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45, 97-160, Tenth Report and Order, 14 FCC Rcd 20156 (1999) (*Tenth Report and Order*), *affirmed*, *Qwest*, 258 F.3d 1191.

[10] *Ninth Report and Order*, 14 FCC Rcd 20432; *Tenth Report and Order*, 14 FCC Rcd 20156. The cost model estimates the forward-looking costs of providing supported services for non-rural carriers. The Commission selected input values for the model in the *Tenth Report and Order*, and found the model provides reasonably accurate cost estimates.

[11] *Qwest*, 258 F.3d at 1202. *See infra* part IV.B 1.

[12] *Qwest*, 258 F 3d at 1202-03 *See infra* part IV C.1.

[13] *Qwest*, 258 F.3d at 1204 *See infra* part IV.D.1.

of federal support for universal service was sufficient and indicated the Commission would have the opportunity on remand to explain further its complete plan for supporting universal service.[14]

D. Joint Board Recommendation

8. On February 15, 2002, the Commission released a Notice of Proposed Rulemaking seeking comment on: (1) how the Commission should define the key statutory terms "reasonably comparable" and "sufficient"; (2) whether, in light of the interpretation of those key statutory terms, the Commission can and should maintain the previously established benchmark or, in the alternative, should adopt a new benchmark or benchmarks; and (3) how the Commission should induce states to implement state universal service policies.[15] Because the *Ninth Report and Order* was based on previous Joint Board recommendations, the Commission determined that further Joint Board input would be beneficial for its consideration of the issues on remand. Accordingly, the Commission referred the issues described in the *Remand Notice*, and the record developed therein, to the Joint Board for a recommended decision.[16]

9. In its *Recommended Decision*, the Joint Board recommended that, for purposes of non-rural high-cost support, sufficiency should be principally defined as enough support to enable states to achieve reasonably comparable rates.[17] The Joint Board also reaffirmed that the statutory principle of sufficiency means non-rural support should be only as large as necessary to achieve its statutory goal.[18] The Joint Board recommended that support should continue to be based on cost differences among states.[19] In addition, the Joint Board supported the continued use of statewide average costs compared to a national cost benchmark for purposes of determining non-rural support amounts, because this methodology reflects an appropriate division of federal and state responsibility for achieving rate comparability for non-rural carrier customers.[20] The Joint Board also supported continued use of a national cost benchmark of 135 percent.[21]

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[14] *Qwest*, 258 F.3d at 1205 *See infra* part IV E.

[15] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Notice of Proposed Rulemaking and Order, 17 FCC Rcd 2999, 3004-10, paras. 12-24 (2002) (*Remand Notice*)

[16] *See id* at 3011, para. 26. The Commission did not refer to the Joint Board the issue of how the non-rural mechanism relates to other funding mechanisms. *See also id* at 3010-11, para. 25.

[17] *Recommended Decision*, 17 FCC Rcd at 20723-24, para 15. *See infra* part IV.B.1

[18] *Recommended Decision*, 17 FCC Rcd at 20724, para. 16. *See infra* part IV.B.1.

[19] *Recommended Decision*, 17 FCC Rcd at 20724-26, paras. 18-21. *See infra* part IV.A.1.

[20] *Recommended Decision*, 17 FCC Rcd at 20727-28, paras. 24-27. *See infra* part IV.A.1.

[21] *Recommended Decision*, 17 FCC Rcd at 20729, para. 34 The *Recommended Decision* printed in the FCC Record is missing two pages, from near the end of paragraph 29 to the middle of paragraph 34. To read these paragraphs, see the *Recommended Decision* located at www fcc.gov/wcb/universal_service/highcost.html under "October 2002 Releases." On Westlaw, the missing pages are identified as being on page 28. *See infra* part IV.C.1.

10. To induce states to achieve reasonably comparable rural and urban rates, the Joint Board recommended that the Commission implement a rate review. States would be required to certify that the basic service rates in their high-cost areas are reasonably comparable to a national urban rate benchmark or explain why they are not.[22] In addition to inducing states to achieve rate comparability, the Joint Board concluded the rate review would allow the Commission to assess whether non-rural high-cost support continues to provide sufficient support to enable states to maintain reasonably comparable rates.[23] States would have the opportunity to demonstrate that further federal action is needed based on a showing that federal support and state actions together are not sufficient to yield reasonably comparable rates.[24] The Joint Board also suggested that the Commission further develop the record on certain issues related to the rate review.[25]

11. On November 5, 2002, a Public Notice invited comment on the Joint Board's recommendations.[26] Comments were filed by December 20, 2002, and reply comments were filed by January 17, 2003.

IV. DISCUSSION

12. Below, we first reaffirm our view that the basic framework of the non-rural high-cost support methodology is consistent with the Act's dual regulatory structure. Next, in response to the specific issues remanded by the court, we define the relevant statutory terms "sufficient" and "reasonably comparable" more precisely for purposes of the non-rural mechanism. Then, we establish a new cost benchmark at two standard deviations above the national average cost, and explain why the level of support provided using this benchmark will be sufficient to ensure that urban and rural rates are reasonably comparable. We then adopt the rate review process recommended by the Joint Board to induce states to achieve reasonably comparable rural and urban rates and to permit assessment of the non-rural mechanism's success in ensuring rate comparability.[27] Finally, we explain further how the federal high-cost support mechanisms work together to provide sufficient support for universal service.

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[22] *Recommended Decision*, 17 FCC Rcd at 20736-37, para. 50. *See infra* parts IV.B.1, IV.D.1.

[23] *Recommended Decision*, 17 FCC Rcd at 20736-40, paras. 50-56. *See infra* part IV.D.1.

[24] *Recommended Decision*, 17 FCC Rcd at 20722, 36-37, paras. 10, 50. *See infra* part IV.D.1.

[25] *Recommended Decision*, 17 FCC Rcd at 20736-38, paras. 50 & n.125, 52-53. *See infra* IV.D.1, V.

[26] *Comment Sought on the Recommended Decision of the Federal-State Joint Board on Universal Service Regarding the Non-Rural High-Cost-Support Mechanism*, Public Notice, CC Docket 96-45, DA 02-2976 (rel. Nov 5, 2002), 67 Fed Reg. 71,121 (2002).

[27] As stated above, we also seek comment on several specific aspects of the rate review process in the attached Further Notice *See infra* part V.

A. Federal and State Roles in Supporting Universal Service

13. Before turning to the specific issues remanded to us for further consideration and explanation, we begin by discussing in more detail the appropriate federal and state roles in supporting universal service. As held in *Texas Office of Public Utility Counsel v. FCC*, section 254 did not affect the proscription in section 2(b) of the Communications Act against Commission regulation of intrastate rates.[28] Thus, our choices in implementing the universal service goals of the Act and in determining the basic framework of the non-rural high-cost support methodology are shaped and limited by the continued dual federal/state jurisdictional structure. A discussion of this framework provides the context needed to fully explain our actions with respect to the specific issues remanded by the court. In addition, a discussion of the dual federal/state jurisdictional roles is a critical backdrop to addressing several commenters' arguments that the Commission must fundamentally alter this basic framework in response to the court's remand decision.

14. As discussed below, we find support in the court's opinion for the basic framework of the non-rural support methodology, which is designed to reflect the division of federal and state roles under the Act. We do not believe that the court's decision requires us to fundamentally alter this framework. We agree with the Joint Board, therefore, that we should continue to determine non-rural high-cost support by comparing statewide average costs to a national cost benchmark. We find no evidence in the record either for radically altering the current non-rural mechanism or for establishing a substantially larger federal subsidy to lower local telephone service rates, as some commenters advocate.

1. Background

15. Historically, the purpose of universal service support always has been to promote universally available telephone service at reasonable and affordable rates.[29] When the 1996 Act was adopted, universal service was achieved largely through implicit support mechanisms.[30] Although the Commission and a few states had in place some explicit support mechanisms to enable access to telephone service in areas where the cost of such service otherwise would be prohibitively high,[31] most universal service support came from state rate designs aimed at

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[28] *Texas Office of Public Utility Counsel v FCC*, 183 F.3d 393, 421, 424, 446-48 (5th Cir. 1999).

[29] *See First Report and Order*, 12 FCC Rcd at 8784, para 10. This proceeding concerns high-cost support mechanisms generally designed to keep rates in high-cost areas affordable by ensuring that rates in these areas are reasonably comparable to rates in low-cost areas. The Commission and most states also have programs designed to make service affordable for low-income consumers.

[30] *See id* at 8784-85, paras. 10-12.

[31] The cost of providing telephone service is largely a function of population density and distance. Sparsely populated, rural areas generally are more expensive to serve than urban areas because rural areas have longer telephone loops, the most expensive portion of the telephone network, and costs are spread among fewer customers. Prior to the implementation of the non-rural high-cost support mechanism adopted in the *Ninth* and *Tenth Report and Orders*, the Commission's high-cost loop support mechanism provided support to non-rural carriers, as well as to rural carriers.

ensuring affordable residential rates.[32] States typically maintained low residential basic service rates through, among other things, geographic rate averaging, higher rates for business customers, higher intrastate access rates, higher rates for intrastate toll service, and/or higher rates for vertical features, such as call waiting. In addition, the federal access charge rate structure provided some implicit support for the interstate portion of joint and common costs.[33]

16. Congress recognized that the universal service support mechanisms developed in a monopoly environment would not be appropriate in the competitive environment envisioned by the 1996 Act. In particular, it would be difficult to sustain implicit subsidies in a competitive market: competition would erode the implicit subsidies that state and, to a lesser extent, federal policies had relied on to keep rates comparable because competitive pressures would drive down above-cost rates.[34] Congress adopted section 254 to help ensure that, as competition develops, explicit support mechanisms would replace, as far as possible, implicit support mechanisms in order to preserve the fundamental communications policy goal of providing universal telephone service in all regions of the nation at reasonably comparable rates.[35]

17. The Act makes clear that preserving and advancing universal service is a shared federal and state responsibility.[36] Among the principles in section 254(b) is that "[t]here should be specific, predictable, and sufficient Federal and State mechanisms to preserve and advance universal service."[37] Pursuant to section 2(b) of the Communications Act, states retain primary responsibility for ensuring reasonable comparability of rates within their borders.[38] In *Texas Office of Public Utility Counsel v. FCC*, the United States Court of Appeals for the Fifth Circuit

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[32] *See First Report and Order*, 12 FCC Rcd at 8784-86, paras. 11, 14.

[33] *See id* at 8784-85, paras. 10-12.

[34] *See Ninth Report and Order*, 14 FCC Rcd at 20441-42 para. 16; *see also Federal-State Joint Board on Universal Service, Access Charge Reform*, Seventh Report & Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, Fourth Report & Order in CC Docket No 96-262, and Further Notice of Proposed Rulemaking, 14 FCC Rcd 8078, 8081-82 paras. 7-8 (1999) (*Seventh Report and Order*).

[35] *See* 47 U S C. § 254(e); S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 131 ("To the extent possible, the conferees intend that any support mechanisms continued or created under new section 254 should be explicit, rather than implicit as many support mechanisms are today.").

[36] *See* 47 U S.C. § 254(b)(5), *Qwest*, 258 F.3d at 1203 ("The Telecommunications Act plainly contemplates a partnership between federal and state governments to support universal service.") (citing 47 U S.C. §§ 254(b)(5), 254(f), 254(k)).

[37] 47 U.S C § 254(b)(5).

[38] *See* 47 U.S C § 152(b). Section 2(b) states that, except as provided in certain designated sections, "nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities or regulations for or in connection with intrastate communication service by wire or radio of any carrier." Section 2(b) predated the 1996 Act and was not amended by that legislation.

held that section 254 of the Act did not affect the proscription in section 2(b) against Commission regulation of intrastate rates.[39]

18. In recognition of the Act's dual federal/state jurisdictional structure, in the *Ninth Report and Order*, the Commission determined, based on the recommendations of the Joint Board, that the primary federal role in ensuring the statutory goal of reasonably comparable rural and urban rates for non-rural carrier customers is to enable reasonable comparability *among* states.[40] By averaging costs at the statewide level, the non-rural high-cost support mechanism adopted in the *Ninth Report and Order* compares the relative costs of providing supported services in different states.[41] The mechanism then provides support to non-rural carriers in those states with costs that exceed the national average by a certain amount, i.e., the national benchmark. This approach ensures that no state with average costs greater than the national benchmark will be expected to keep rates reasonably comparable without the benefit of federal support.

19. The Tenth Circuit recognized that the 1996 Act "plainly contemplates a partnership between the federal and state governments to support universal service."[42] The court further recognized that the Commission "may not be able to implement universal service by itself, since it lacks jurisdiction over intrastate service," citing section 2(b) of the Communications Act.[43] The court rejected the petitioner's argument "that the FCC alone must support the full costs of universal service."[44] The court also rejected the petitioner's argument "that the use of statewide and national averages is necessarily inconsistent with [section] 254."[45] Thus, the court's decision recognizes the Act's dual federal/state jurisdictional structure.

20. In response to the court's decision, the Joint Board affirmed its belief that the non-rural mechanism reflects the appropriate division of federal and state responsibility for achieving reasonably comparable rural and urban rates for non-rural carrier customers. The Joint Board explained that "[b]ecause the states, not the Commission, set intrastate rates, the states have primary responsibility for ensuring reasonably comparable rural and urban rates."[46]

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[39] *Texas Office of Public Utility Counsel v FCC*, 183 F.3d at 421, 424, 446-48.

[40] *See Ninth Report and Order*, 14 FCC Rcd at 20454, para. 38.

[41] *See id* at 20457-58, paras. 45-46.

[42] *Qwest*, 258 F.3d at 1203.

[43] *Id* at 1203.

[44] *Id* at 1203.

[45] *Id* at 1202 n.9 The petitioner argued that support should be based on a comparison of wire center costs, rather than a comparison of statewide average costs. Although the court rejected the Commission's justification for the 135% national average cost benchmark, the court noted that "[i]f, however, the FCC's 135% benchmark actually produced urban and rural rates that were reasonably comparable . . . we likely would uphold the mechanism" *Id.* at 1202.

[46] *Recommended Decision*, 17 FCC Rcd at 20727, para 24.

Because some states cannot support their high-cost areas by using resources from their low-cost areas, "[t]he Commission's primary role is to identify those states that do not have the resources within their borders to support all of their high-cost lines."[47]

2. Discussion

21. Consistent with the Act's dual jurisdictional structure, we agree with the Joint Board that the states should continue to have primary responsibility for ensuring reasonably comparable rural and urban rates, and that the Commission's primary role under the non-rural mechanism is to identify those states that do not have the resources within their borders to support all of their high-cost lines. The 1996 Act makes clear that Congress intended preserving and advancing universal service to be a shared federal and state responsibility.[48] The legislative history of the 1996 Act also indicates that Congress intended the states to continue to have the primary role in implementing universal service for intrastate services.[49] In designing the non-rural mechanism, the Commission left intact the states' primary jurisdiction over intrastate support.[50] The Commission stated that "it would be unfair to expect the federal support mechanism, which by its very nature operates by transferring funds among jurisdictions, to bear the support burden that has historically been borne within a state by intrastate, implicit support mechanisms."[51] The Tenth Circuit's decision supports the view that Congress did not intend the Commission to federalize the dual federal/state universal service support system by converting implicit state subsidies to explicit federal subsidies and taking on the entire burden of providing support for intrastate costs in high-cost and rural areas. The court said that it saw "nothing in [section] 254 requiring the FCC to replace implicit support previously provided by the states

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[47] *Id* at 20727, para. 25.

[48] *See* 47 U.S C § 254(b)(5) ("There should be specific, predictable, and sufficient Federal and State mechanisms to preserve and advance universal service.").

[49] *See* S. Rep. No. 23, 104th Cong., 1st Sess. 25. (". the Committee intends that States shall continue to have the primary role in implementing universal service for intrastate services . . .").

[50] *See Ninth Report and Order*, 14 FCC Rcd at 20458, para. 46.

[51] *Id* at 20458, para. 46 (quoting the *Seventh Report and Order*, 14 FCC Rcd at 8101, para. 46). The Commission explained in the *Ninth Report and Order* that the non-rural high-cost support mechanism "has the effect of shifting money from relatively low-cost states to relatively high-cost states," by identifying states whose average costs are significantly above the national average and providing federal support to those high-cost states. *Id* at 20457, para 45 The non-rural high-cost support mechanism does not directly shift funds from low-cost to high-cost states. Rather, contributions to universal service are based on interstate telecommunications revenues, and interstate carriers typically pass these charges onto their customers. More populous states, which tend to be low-cost, have more interstate customers than sparsely populated states, which tend to be high-cost, so that customers in more populous states effectively bear the cost of funding universal service. As the Joint Board and the Commission have previously noted, only the federal jurisdiction can shift funds among states. *See id* at 20458, para 47; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision,13 FCC Rcd 24754, 24760, para. 37 (1998) (*Second Recommended Decision*).

with explicit federal support."[52] Indeed, the court rejected the petitioner's argument that the Commission alone must support the full costs of universal service.[53]

22. Moreover, primary state responsibility for ensuring intrastate rate comparability is consistent with state ratemaking authority under the Act. The states, not the Commission, set intrastate rates.[54] Since passage of the 1996 Act, many states have adopted explicit universal service support mechanisms, but most states continue to provide at least some implicit support to residential customers through their rate designs.[55] Given the substantial amounts of universal service support built into most state rate designs, the Commission previously observed that "states are best positioned to determine how and whether these [implicit] mechanisms need to be altered to ensure that carriers do not double-recover universal service support."[56] We continue to believe that the states are in the best position to assess the impact of competition on the erosion of implicit support in their jurisdictions and adjust their universal service mechanisms accordingly.[57] We believe that the states generally are fulfilling their responsibilities under the

[52] *Qwest*, 258 F.3d at 1204. *See also* AT&T Comments at 9 ("If Congress had felt there was a need for significant new subsidies to achieve "reasonably comparable" rates, it would have explicitly authorized such a program through express statutory command.").

[53] *Qwest*, 258 F.3d at 1203. Contrary to SBC's assertion, the court did not "direct[] the Commission on remand to take responsibility for the sufficiency of funding in all 'areas,' including those that fall within states that have unexceptional statewide averages." *See* SBC Reply Comments at 2.

[54] *See Recommended Decision*, 17 FCC Rcd at 20727, para. 24.

[55] For example, in response to a survey of state commissions conducted by the United States General Accounting Office (GAO), 21 states report having programs that provide assistance to high-cost local exchange carriers. *See* United States General Accounting Office, *Telecommunications Federal and State Universal Service Programs and Challenges to Funding* at 39 (GAO-02-187, Feb. 4, 2002) (GAO Report). Fourteen states report having programs that provide assistance to small local exchange carriers. *Id* at 40. In most states, rates for residential customers of the largest local exchange carriers are geographically averaged, either throughout the company's service territory, in broad geographic areas, or in areas with similar geographic size and number of access lines. *Id* at 36 In states where non-rural carriers have multiple geographic areas over which rates are averaged, more than half report using value-of-service pricing to establish relative rates for different geographic areas, which results in lower rates in rural, less populous areas relative to rates in urban areas. *Id.* at 15, 36. *See also* Wisconsin Comments at 6. In all but one state, residential rates are lower than single-line business rates in the same geographic area GAO Report at 37 About half the states report setting intrastate long distance access charges above cost to subsidize basic local service *Id* at 37.

[56] *See Seventh Report and Order*, 14 FCC Rcd at 8110 para. 65 (1999). *See also First Report and Order*, 12 FCC Rcd at 8888-89, para 202 ("We believe that existing levels of implicit intrastate support are substantial. We find, however, that states, acting pursuant to section 254(f) and 253 of the Act, must in the first instance be responsible for identifying implicit intrastate universal service support.").

[57] Although this belief does not constitute a directive to do so, the Commission has stated its belief that, "as competition develops, states may be compelled by marketplace forces to convert implicit support to explicit, sustainable mechanisms consistent with section 254(f)." *First Report and Order*, 12 FCC Rcd at 8888-89, para. 202.

Act, with the help of federal support in high-cost states, to ensure reasonably comparable rates in rural and urban areas within their borders.[58]

23. We also agree with the Joint Board that we must consider cost differences in determining which states need federal support to achieve rural rates that are comparable to urban rates.[59] Because the states retain jurisdiction over intrastate rates, the Joint Board and the Commission always have looked at cost differences, not rate differences, in determining high-cost support.[60] States may base rates on a variety of factors, so that comparing only rates, which may or may not include implicit support, would not be a fair and equitable way to apportion federal support.[61] Because the underlying purpose of rates is to recover the cost of providing service, comparing costs provides a more accurate and consistent measure of what rate differences would be in any given state, given identical state rate policies. States with high costs would have higher rates in the aggregate than those in other states, were it not for federal support. We disagree with the argument that the statutory principle of reasonable comparability requires the determination of non-rural support to be based on rate differences.[62] We find nothing in the court's remand decision that requires such an approach.[63] The advocates of such

[58] The Joint Board found that the GAO Report supported a finding that current rates are affordable and reasonably comparable. *See Recommended Decision*, 17 FCC Rcd at 207329, para. 34, *supra* note 21. As discussed below, based on further analysis of the GAO Report data, rural rates in most states would be presumed to be reasonably comparable to the national urban rate benchmark adopted in this Order. *See infra* part IV.C. As also discussed below, we adopt in this Order the Joint Board's recommendation to implement a procedure that will induce states to achieve reasonably comparable rates and enable the Commission to take additional action, if necessary, to achieve comparable rates. *See Recommended Decision*, 17 FCC Rcd at 20736, para. 50; *infra* part IV.D.

[59] *See Recommended Decision*, 17 FCC Rcd at 20725-26, paras. 19-20. Most commenters agree that support should be based on a comparison of costs, not rates. *See, e g.*, AT&T Comments at 13-14; California Comments at 6, Maine Comments at 6-9, 19; Montana/Vermont Comments at 40-44; New York Comments at 3; Verizon Comments 5-6, Verizon Reply Comments at 3 ("There is general agreement among the commenters, even those opposing the Joint Board's recommended decision, that universal service support should be based on comparisons of costs, not rates.").

[60] *See Second Recommended Decision*, 13 FCC Rcd at 24754, para. 19; *Ninth Report and Order*, 14 FCC Rcd at 20453-54, paras 36-38; *Recommended Decision*, 17 FCC Rcd at 20724-26, paras, ~~17-21~~.

[61] For example, a state could decide as a policy matter that universal service should include intrastate toll services and fund such services by increasing local telephone rates to levels that are not comparable to rates in other states If this state were thereby eligible for more federal support, it would burden the federal universal service support mechanism Pursuant to section 254(f) of the Act, the state could expand its definition of universal service to include intrastate toll services, but it would be required to fund these additional services through its own universal service mechanisms without relying on federal support. *See* 47 U.S C. § 254(f). *See also* California Comments at 13; Verizon Reply Comments at 3 (arguing that a direct comparison of rates is an unreliable indicator of a state's need for federal support).

[62] *See* Surewest Comments at 6-7.

[63] *Cf Qwest*, 258 F.3d at 1202 ("As noted above, the FCC has substituted a comparison of national and statewide [cost] averages for the statutory comparison of urban and rural rates. If, however, the FCC's 135% [cost] benchmark actually produced urban and rural rates that were reasonably comparable, . . . we likely would uphold the mechanism.").

an approach have not suggested methods of apportioning non-rural support based on rate differences that would be fair, equitable, or administratively manageable. Moreover, nothing in the record suggests that basing non-rural support on cost differences will not result in reasonably comparable rural and urban rates. Indeed, as discussed below, we find that our cost-based non-rural support mechanism has achieved rates that generally are reasonably comparable.[64]

24. We also agree with the Joint Board that the general framework of the non-rural mechanism, through the use of statewide average costs, reflects the appropriate division of federal and state responsibility for determining high-cost support for non-rural carriers.[65] The non-rural mechanism estimates costs by determining the average cost in each wire center, weighted by lines, and then averaging the wire center costs at the state level, weighted by lines. In effect, this "nets out" the high-cost and low-cost lines in a state. States with high average costs do not have enough low-cost lines to support their high-cost areas. High-cost states receive federal non-rural support, which is targeted to their high-cost wire centers.[66] This is the most reasonable way to identify the states that do not have enough non-rural carrier low-cost lines to keep their rural rates reasonably comparable to urban rates in most other states. Statewide averaging effectively enables the state to support its high-cost wire centers with funds from its low-cost wire centers through implicit or explicit support mechanisms, rather than unnecessarily shifting funds from other states.[67]

25. We recognize, as the Joint Board observed, that statewide averaging may not be appropriate for the high-cost mechanism providing support to rural carriers.[68] Compared to non-rural carriers, rural carriers generally serve fewer subscribers, serve more sparsely populated areas, and generally do not benefit from economies of scale and scope as much as non-rural carriers.[69] In addition, compared to customers of non-rural carriers, customers of rural carriers tend to have a relatively small local calling scope and make proportionately more toll calls.[70] Most non-rural carriers historically have received lower levels of high-cost support than rural carriers. Specifically, the high-cost loop support mechanism provides a greater percentage of federal support to carriers with 200,000 or fewer lines.[71] In the future, we intend to ask the Joint

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[64] *See infra* part IV C.2

[65] *See Recommended Decision*, 17 FCC Rcd at 20727, para. 24.

[66] Although average costs are used to determine total statewide non-rural support amounts, support is targeted to wire centers based on relative cost. *Ninth Report and Order*, 14 FCC Rcd at 20470-73, paras. 68-76.

[67] *See Ninth Report and Order*, 14 FCC Rcd at 20460, para. 49; *see also supra* note 51.

[68] *See Recommended Decision*, 17 FCC Rcd at 20728, para 28.

[69] *See First Report and Order*, 12 FCC Rcd at 8936, para. 294.

[70] *See* Rural Task Force, White Paper 2: The Rural Difference 11 (January 2000).

[71] *See* 47 C F R. § 36 631(c)-(d) Prior to the 1996 Act, both rural and non-rural carriers were eligible for federal support under the Commission's high-cost loop support mechanism. That mechanism provides gradually more support for costs that exceed the national average cost by certain percentages. For example, carriers with 200,000 or fewer lines receive support for 65% of the costs above 115% percent of the national average cost, and for 75% of the costs above 150% Carriers with more than 200,000 lines receive support for 10% of the costs (continued....)

Board to conduct a comprehensive review of the high-cost support mechanisms for rural and non-rural carriers as a whole to ensure that both mechanisms function efficiently in a coordinated fashion.[72]

26. Several commenters criticize the *Recommended Decision* for appearing to endorse continued reliance on implicit subsidies.[73] While we generally agree that states should be encouraged to replace implicit support with explicit support mechanisms, we are not persuaded that, to comply with the court's remand, we must require or induce all states to immediately remove implicit subsidies from intrastate rates through substantial increases in federal support.[74] We do not find in the language of the statute, as SBC does,[75] a clear mandate requiring states to establish explicit universal service support mechanisms.[76] Although section 254 states a clear preference for explicit, rather than implicit, support, the Joint Board and the Commission previously agreed that the 1996 Act does not require states to adopt explicit universal service support mechanisms.[77] Section 254(e), which provides that support should be explicit, refers

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above 115% percent of the national average cost, 30% for costs above 160%, 60% for costs above 200%, and 75% for costs above 250%. These percentages are based on Joint Board recommendations from the 1980's that the Commission increase high-cost assistance for study areas with 200,000 lines or fewer and decrease assistance for larger study areas from previous levels. The Joint Board premised its recommendation on the assumption that larger companies have greater flexibility in how they recover above-average costs than smaller companies. *See MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, Recommended Decision and Order, CC Docket Nos 78-72, 80-286, 2 FCC Rcd 2324, 2334 (1987).

[72] *See Rural Task Force Order*, 16 FCC Rcd at 11310, para. 169; *Remand Notice*, 17 FCC Rcd at 3011-12, paras 27-28.

[73] *See, e.g*, CUSC Comments at 12 ("Rather than approving and continuing to rely on such a monopoly-based policy as statewide averaging, the Commission should work with the states to phase out and ultimately eliminate such implicit subsidies."); SBC Comments at 6 ("[T]he *Recommended Decision* tacitly endorses the use of implicit subsidies as a legitimate way for states to support universal service, even though implicit subsidy mechanisms are unsustainable and contrary to the requirements of section 254."); Qwest Comments at 9 ("It appears that a state could certify that rates within its borders are reasonably comparable, even if such comparability depends on continued existence of implicit subsidies.").

[74] *See e g*, SBC Comments at 17 (arguing that the Commission "should immediately initiate a proceeding to establish inducements or agreements for states to establish residential pricing structures that would allow prices for residential local service to rise to levels that are self-supporting"); Qwest Comments at 8 (arguing that many "states are unlikely to replace implicit subsidies until they have reached a crisis point where these subsidies have been virtually eliminated") Although we do not agree with SBC and Qwest that substantial increases in federal support are warranted, we seek comment in the attached Further Notice of Proposed Rulemaking whether we should make some additional targeted federal support available for high-cost wire centers in states that implement explicit universal service mechanisms. *See generally* SBC Comments; Qwest Comments; *infra* part V.D.

[75] *See, e g*, SBC Comments at 11 ("the Joint Board appears to accept that implicit subsidies can continue unabated, notwithstanding the plain language of section 254"); SBC Comments at 24 ("the elimination of implicit subsidies is a statutory imperative")

[76] Several commenters agree with our analysis. *See, e g.*, NASUCA Comments at 3-5, Verizon Reply Comments at 16.

[77] *See Seventh Report and Order*, 14 FCC Rcd at 8102, para. 45 (1999).

only to federal, not state, universal service support.[78] Section 254(f), which provides that states *may* adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service, does not include the word "explicit."[79] In addition, requiring the states to establish explicit universal service support mechanisms raises serious legal concerns in light of section 2(b) of the Communications Act.[80] Requiring the states to remove implicit support from their rate structures arguably would involve the Commission in the regulation of intrastate rates.[81]

27. We disagree with some commenting states that the Commission must significantly increase federal support by adopting an urban cost benchmark.[82] They claim that the Joint Board's premise, that Congress sought to prevent prospective harm due to competition, narrows and distorts the purpose of section 254.[83] We are not persuaded by their arguments. In particular, we find no evidence for one state's claim that section 254(b) was intended to address a pending waiver petition of a specific Commission rule related to high-cost support for larger carriers.[84] Nothing in the 1996 Act's language or legislative history suggests such an intention. If Congress intended to address a particular Commission proceeding in section 254, it knew how

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[78] *See* 47 U.S.C. § 254(e).

[79] *See* 47 U.S C. § 254(f) (emphasis added).

[80] *See* 47 U.S C. § 152(b); *see also supra* para 17. SBC claims that the Commission has the authority to end state reliance on implicit subsidies by establishing general universal service pricing standards and setting a deadline for state compliance. SBC Comments at 17, 19. A similar process is used to implement the local competition provisions of the 1996 Act, in which the Commission sets pricing guidelines and the states set specific rates. This process was upheld by the Supreme Court. *See AT&T v. Iowa Utilities Board*, 525 U.S. 366, 377-386 (1999). We need not decide at this time whether or not the Commission would have the authority to set pricing standards because, as discussed below, we do not agree that rates must be rebalanced without delay. *See infra* para. 77, *see also* Wisconsin Comments at 7 (noting that a significant competitive presence in residential markets has been seen only in recent years and competitive impact has not been geographically ubiquitous).

[81] The Commission also has not attempted to identify existing state-determined intrastate implicit universal service support effectuated through intrastate rates or other state decisions. Attempting to identify, compare, and evaluate implicit support mechanisms in each state arguably could result in the Commission second-guessing state ratemaking decisions.

[82] *See generally*, Maine Comments; Montana and Vermont Comments; Maine Reply Comments.

[83] *See* Montana and Vermont Comments at 16-18.

[84] *See* Maine Reply Comments at 2. As previously noted, prior to the 1996 Act, both rural and non-rural carriers were eligible for federal support under the Commission's high-cost loop support mechanism, which provides support based on embedded costs. That mechanism provides gradually more support for costs that exceed the national average cost by certain percentages and provides greater levels of support for carriers serving 200,000 or fewer lines than for carriers serving more than 200,000 lines. *See* 47 C.F.R. § 36.631, *supra* note 71. Vermont had a request for waiver of this rule pending before passage of the Act requesting that Verizon-Vermont (formerly New England Telephone and Telegraph), serving 270,000 lines, receive the amount of high-cost loop it would have received if it had served 200,000 or fewer lines. *See* Petition for Waiver of Section 36.631 of the Commission's Rules Governing the Universal Service Fund, filed by the Vermont Department of Public Service and the Vermont Public Service Board, September 21, 1993, AAD 93-103. Maine claims that the 1996 Act established funding standards that made Vermont's petition moot. *See infra* note 89 and accompanying text.

to make its intention clear.[85] For example, the conference report explains that section 254(g) is intended to incorporate the Commission's rate integration policies contained in a specific Commission order.[86] Rather than directing the Commission to establish any particular universal service support mechanism, we find that a better reading of the statute is that Congress provided general principles and goals in section 254 to preserve and advance universal service as competition develops.[87] The Commission already had in place federal support mechanisms that had the effect of shifting support among states. Pursuant to section 254, the Commission adapted those mechanisms to be sustainable and appropriate for a competitive environment.[88] We find nothing in the statute to support the commenting states' contention that we should dramatically increase federal support flows among states. We note that actions taken by the Commission in implementing the 1996 Act rendered the waiver petition moot.[89]

28. We also agree with the Joint Board that, for purposes of determining non-rural high-cost support, comparing statewide average costs to the nationwide average cost, rather than to an urban average cost, more appropriately reflects the division of federal and state responsibility under the Act as outlined above.[90] Because the national urban average cost is

[85] *See* AT&T Comments at 2, 9.

[86] *See* 47 U.S.C. § 254(g); S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 132 (citing *Integration of Rates and Services for the Provision of Communications by Authorized Common Carriers between the United States Mainland and the Offshore Points of Hawaii, Alaska, and Puerto Rico/Virgin Islands* (61 FCC2d 380 (1976))). The conference report references another Commission proceeding with regard to section 254(a): "the conferees do not view the existing proceeding under Common Carrier Docket 80-286 (regarding amendment of Part 36 of the Commission's Rules and appointment of a Joint Board) as an appropriate foundation on which to base the proceeding required by new section 254(a)." *See* 47 U.S.C. § 254(a), S. Conf Rep. No. 230, 104th Cong., 2d Sess. 131.

[87] The 1996 Act explicitly preserves the traditional authority of the Commission and the states to impose carrier-of-last-resort obligations on carriers and to generally promote universal service. *See* 47 U.S C. §§ 214(e), 254.

[88] *See First Report and Order*, 12 FCC Rcd at 8926-34, paras. 273-90. For example, high-cost loop support previously was funded only by interexchange carriers. Section 254(e) requires that all telecommunications carriers providing interstate service contribute to the universal service support mechanisms and the Commission changed its funding mechanisms accordingly. *See* 47 U.S.C. § 254(e). In addition, whereas high-cost support previously was available only to incumbents and was averaged over an entire study area, the Commission made high-cost support competitively neutral, portable, and targeted to high-cost areas. *See First Report and Order*, 12 FCC Rcd at 8932-34, paras. 286-90; *Ninth Report and Order*, 14 FCC Rcd at 20470-73, paras. 68-76. *See also Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order, 17 FCC Rcd 22642 (2002) (*Referral Order*); *infra* part IV.E.

[89] For the reasons discussed in paragraph 27, we do not agree that mere passage of the 1996 Act rendered Vermont's petition moot. Subsequent actions by the Commission in implementing the 1996 Act, however, did make Vermont's petition moot. Specifically, in the *First Report and Order*, the Commission determined support should be based on forward-looking economic costs, rather than embedded costs, and that larger, non-rural carriers would transition to forward-looking support before smaller, rural carriers. Pursuant to the rules adopted in the *Ninth Report and Order*, beginning January 1, 2000, Verizon-Vermont and other non-rural carriers began receiving support based on forward-looking costs The rule challenged by Vermont currently applies only to rural carriers and non-rural carriers receiving hold-harmless support.

[90] *See Recommended Decision*, 17 FCC Rcd at 20,733-34, para. 39-41. *See supra* paras. 21-22. *See also* AT&T Reply Comments at 2 ("[B]asing the benchmark on urban cost is inappropriate when designing the *federal* high-(continued....)

lower than the national average cost, the effect of using the national urban average cost, assuming use of the same cost benchmark, would be to increase federal support. For example, using the benchmark proposed by the proponents of an urban average cost benchmark would increase federal non-rural support from approximately $214 million to an estimated $1.7 billion.[91] We do not need to use an urban cost benchmark in order to achieve rural rates that are reasonably comparable to urban rates because, as explained below, we conclude that the current level of federal support has resulted in rural and urban rates that generally are reasonably comparable.[92] Using an urban cost benchmark (or obtaining the same result with a lower national average cost benchmark) would simply increase the amount of federal support, thereby driving the costs to be supported with federal funds down to the lower-than-average urban level.[93] That is, federal support would be used to reduce overall intrastate rate levels by replacing the support in state rates with federal support. As discussed above, we do not believe that the 1996 Act or the court's remand requires the Commission to replace the implicit support historically provided by states with explicit federal support, thereby significantly increasing the federal burden for supporting intrastate costs.[94] Moreover, as discussed below, significantly increasing the amount of federal support without evidence that such a measure is necessary to achieve rural and urban rate comparability would be inconsistent with the statutory principle of sufficiency.[95]

29. We reaffirm that comparing statewide average costs to a nationwide cost benchmark reflects the appropriate federal and state roles in determining federal non-rural high-cost support amounts. We find that the basic framework of the non-rural support methodology is consistent with the court's view that the Commission is not required by the Act to replace

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cost support mechanism, because it ignores the fact that states must use intrastate resources in the first instance to make rates comparable.")(emphasis in original).

[91] *See* Verizon Reply Comments at 4. Proponents of the urban cost benchmark concede that the same result could be achieved by lowering the nationwide benchmark. *See* Montana and Vermont Comments at 48. Thus, we see no merit to the argument that comparing statewide average costs to a nationwide cost benchmark is a fundamentally different exercise than comparing statewide average costs to an urban cost benchmark. Both methodologies identify states with high average costs. *See* Maine Comments at 9 (arguing that any support system "must support those states with high average costs").

[92] *See infra* part IV.C.2.

[93] As explained in more detail below, using an urban cost benchmark would exaggerate the need for federal support to ensure rate comparability. *See infra* paras. 68-69. *See also* Verizon Reply Comments at 6 ("[A]n urban cost benchmark would produce more support than is necessary to enable states to maintain reasonably comparable rates, and the excessive size of a fund based on an urban benchmark would be adverse to other universal service principles of sufficiency and affordability."). AT&T points out that Maine and Vermont, proponents of the urban cost benchmark, have two of the highest penetration rates in the country, and that the non-rural carrier in those states, Verizon, opposes any increase in federal non-rural support. *See* AT&T Reply Comments at 6.

[94] *See supra* para. 21. *See also Ninth Report and Order*, 14 FCC Rcd at 20455, para. 57 ("[W]e do not believe it would be equitable to expect the federal mechanism – and thus ratepayers nationwide – to provide support to replace implicit state support that has been eroded by competition if the state possesses the resources to replace that support through other means at the state level."), Verizon Comments at 10; Wisconsin Comments at 2.

[95] *See infra* parts IV.B., IV.C.

implicit state support with explicit federal support or to support the full costs of universal service.

B. Definitions of Relevant Statutory Terms

30. We now turn to the specific issues remanded by the court. Consistent with the Joint Board's recommendations, we define "sufficient" for purposes of the non-rural mechanism in terms of the statutory principle in section 254(b)(3), as enough federal support to enable states to achieve reasonable comparability of rural and urban rates in high-cost areas served by non-rural carriers. We also agree with the Joint Board that the principle of sufficiency means that non-rural high-cost support should be only as large as necessary to meet the statutory goal. In addition, we establish a more precise definition of "reasonably comparable" rural and urban rates, based on the Joint Board's recommended national urban rate benchmark, for purposes of assessing whether the non-rural mechanism is sufficient to achieve reasonably comparable rates.[96] Specifically, we define "reasonably comparable" rates in terms of a rate benchmark based on the most recent urban residential rates in the *Reference Book*, the Wireline Competition Bureau's annual rate survey.[97] By adopting a rate benchmark based on actual data, we will help ensure that rural rates remain reasonably comparable to urban rates as market conditions and rates change over time.

1. Background

31. Section 254(b) provides that "[t]he Joint Board and the Commission shall base policies for the preservation and advancement of universal service" on certain principles, two of which the court found were relevant to this proceeding.[98] Section 254(b)(3) provides that consumers in rural, insular, and high-cost areas should have access to telecommunications services at rates that are "reasonably comparable to rates charged for similar services in urban areas."[99] Section 254(b)(5) provides that "[t]here should be specific, predictable, and sufficient Federal and State mechanisms to preserve and advance universal service."[100] In addition, section 254(e) provides that any federal universal service support "should be explicit and sufficient to achieve the purposes of this section."[101]

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[96] As discussed below in part IV.D.2.a, we adopt the Joint Board's recommendation to establish a national urban rate benchmark based on the most recent average urban residential rate in the Bureau's annual rate survey.

[97] *See* Industry Analysis and Technology Division, Wireline Competition Bureau, *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service* (July 2003) (*2003 Reference Book*).

[98] 47 U.S.C. § 254(b); *Qwest*, 258 F.3d at 1199.

[99] 47 U.S.C. § 254(b)(3).

[100] 47 U.S.C. § 254(b)(5).

[101] 47 U.S.C. § 254(e).

32. In the *Ninth Report and Order*, the Commission stated that the non-rural high-cost support mechanism would "provide sufficient support to enable reasonably comparable rates."[102] While the Act does not define "reasonably comparable," the Joint Board and the Commission interpreted the reasonable comparability standard to refer to "a fair range of urban/rural rates both within a state's borders, and among states nationwide."[103] The Commission interpreted the goal of maintaining a "fair range" of rates to mean that "support levels must be sufficient to prevent pressure from high costs and the development of competition from causing unreasonable increases in rates above current, affordable levels."[104] The Commission explained that "reasonably comparable does not mean that rate levels in all states, or in every area of every state, must be the same," but rather means "some reasonable level above the national average forward-looking cost per line, i.e., greater than 100 percent of the national average."[105]

33. The court found that the Commission did not define adequately the key statutory terms "reasonably comparable" and "sufficient."[106] The court observed that the Commission's definition of reasonably comparable as a fair range of urban/rural rates failed to address petitioners' claim that some rural rates will be 70 to 80 percent higher than urban rates under the non-rural mechanism.[107] The court also found that the Commission's further explanations of the meaning of reasonably comparable could not be considered reasonable interpretations of the statutory language, because "[t]he Act calls for reasonable comparability between rural and urban rates."[108] The court stated that the Commission's further definitions "simply substitute different standards."[109] The court also concluded that the Commission asserted without explanation in the *Ninth Report and Order* that the non-rural mechanism would be sufficient.[110] The court declared the Commission's holding conclusory and, thus, "inadequate to enable appellate review of the sufficiency of the federal mechanism."[111] The court required the Commission on remand to define "reasonably comparable" and "sufficient" "more precisely in a

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[102] *Ninth Report and Order*, 14 FCC Rcd at 20464, para. 56

[103] *Seventh Report and Order*, 14 FCC Rcd at 8092, para. 30 (adopting the Joint Board's interpretation in the *Second Recommended Decision*, 13 FCC Rcd at 24753, para. 18); *see also Ninth Report and Order*, 14 FCC Rcd at 20461, para. 54.

[104] *Seventh Report and Order*, 14 FCC Rcd at 8092 para. 30; *see also Ninth Report and Order*, 14 FCC Rcd at 20446, para. 24

[105] *Ninth Report and Order*, 14 FCC Rcd at 20463 para. 54; *see also Seventh Report and Order*, 14 FCC Rcd at 8092, para. 30.

[106] *Qwest*, 258 F. 3d at 1201.

[107] *Id* Petitioners clarify in their comments filed in this proceeding that the 70-80% discrepancy relates to cost differences, not rate differences. *See* Maine Comments at 6 n.4; Montana and Vermont Comments at 3 n.6.

[108] *Qwest*, 258 F 3d at 1201

[109] *Id*

[110] *Id See Ninth Report and Order*, 14 FCC Rcd at 20464, para 56

[111] *Qwest*, 258 F.3d at 1201.

way that can be reasonably related to the statutory principles, and then assess whether its funding mechanism will be sufficient for the principle of making rural and urban rates reasonably comparable."[112]

34. In response to the court remand, the Joint Board recommended that, for purposes of non-rural high-cost support, sufficiency should be principally defined as enough support to enable states to achieve reasonably comparable rates.[113] The Joint Board reasoned that sufficiency should be defined in terms of the relevant statutory goals found in section 254(b) and, therefore, the definition of sufficiency may vary depending on the underlying purpose of the universal service program in question.[114] The Joint Board found that the principal purpose of the non-rural high-cost support mechanism is to provide enough federal support to enable states to achieve reasonable comparability of rural and urban rates, the principle found in section 254(b)(3).[115] The Joint Board also found that correct fund size is essential to ensure that all consumers benefit from universal service, and reaffirmed its view that the statutory principle of sufficiency means that non-rural high-cost support should be only as large as necessary to achieve its statutory goal.[116]

35. Although the Joint Board did not explicitly propose a definition of "reasonably comparable," in its *Recommended Decision*, it recommended that the Commission require states to certify annually that their rates are reasonably comparable or explain why they are not. Specifically, the Joint Board recommended that the Commission establish a "safe harbor" whereby a state whose rates in high-cost areas served by non-rural carriers are at or below a certain rate benchmark may certify that its basic service rates are reasonably comparable without the necessity of submitting additional information.[117] The Joint Board recommended that the Commission base the rate benchmark on the most recent average urban residential rate in the Wireline Competition Bureau's *Reference Book*, an annual survey of local telephone rates in ninety-five urban areas that the Bureau has conducted for the past seventeen years.[118] The Joint Board suggested that 135 percent of this average rate may be an appropriate rate benchmark for the safe harbor, but recommended that the Commission further develop the record on the appropriate rate benchmark.[119] The rate benchmark would establish a presumption that rates are

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[112] *Id* at 1202.

[113] *Recommended Decision*, 17 FCC Rcd at 20723-24, para 15

[114] *Id* at 20723-24, para. 15.

[115] *Id.*

[116] *Id* at 20724, para.16.

[117] *Id* at 20736-37, para 50. *See infra* part IV.D.1.

[118] *See 2003 Reference Book* at 1-10. The average rate in the most recent *Reference Book* survey includes a monthly charge for flat-rate service, federal and state subscriber line charges, additional monthly charges for touch-tone service, and taxes, 911 and other charges *See id.* at 3. *See also Recommended Decision*, 17 FCC Rcd at 20736-38, para. 49 & n.124, para. 52.

[119] *See Recommended Decision*, 17 FCC Rcd at 20738, para 52

reasonably comparable, but states could submit additional information to demonstrate that other factors affect the comparability of their rates.[120]

2. Discussion

36. We agree with the Joint Board that "sufficient" should be defined, for purposes of the non-rural mechanism, as enough federal support to enable states to achieve reasonably comparable rural and urban rates. We also agree that "sufficient" should be defined in terms of the statutory principle in section 254(b) that the particular universal service program is designed to achieve.[121] The non-rural high-cost support mechanism is designed to help ensure that consumers in high-cost areas, served by non-rural carriers, have access to telecommunications services at rates that are reasonably comparable to rates charged for similar services in urban areas.[122] As explained in part IV.A.2. above, the non-rural mechanism achieves this goal by identifying and providing support to those states that do not have the resources within their borders to achieve reasonably comparable rural and urban rates for their non-rural carrier customers. Accordingly, for purposes of the non-rural mechanism, we define "sufficient" in terms of the section 254(b)(3) principle of reasonable comparability of rural and urban rates.

37. We also agree with the Joint Board that the principle of sufficiency encompasses the idea that the amount of support should be only as large as necessary to achieve the relevant statutory goal.[123] Because support ultimately is recovered from customers, collecting more support than is necessary to benefit certain customers would needlessly burden all customers.[124] We agree with the Joint Board that correct fund size is essential to ensure all consumers benefit from universal service.[125] In discussing whether support is sufficient, the Commission previously cited the Fifth Circuit's suggestion that "excessive funding may itself violate the sufficiency requirements of the Act."[126] We find that the idea of minimizing the burden on

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[120] *See id.* at 20737, para. 50.

[121] *See id.* at 20723-24, para. 15.

[122] *Ninth Report and Order*, 14 FCC Rcd at 20434-35, para. 2

[123] *See Recommended Decision*, 17 FCC Rcd at 20724, para. 16. *See also Ninth Report and Order*, 14 FCC Rcd 20465 para. 58.

[124] *See, e g.,* AT&T Comments at 12; California Comments at 5 ("California agrees with the Commission that a mechanism that produces a federal universal service fund at or near the existing level produces affordable rates, balances the interests of contributor and recipient states, and therefore satisfies the goal of universal service."), NASUCA Comments at 8 ("NASUCA supports the Joint Board's recognition that "sufficient" implies "no more than sufficient."); Verizon Comments at 5 ("A fund that is too large would increase costs for all consumers and impair the ability of some customers to continue subscribing to telephone service.").

[125] *Recommended Decision*, 17 FCC Rcd at 20724, para. 16. *See also Second Recommended Decision*, 13 FCC Rcd at 24756 para. 3 ("The transition to a competitive environment requires us to be mindful of two competing goals: (1) supporting high cost areas so that consumers there have affordable and reasonably comparable rates; and (2) maintaining a support system that does not, by its sheer size, over-burden consumers across the nation.").

[126] *See Rural Task Force Order*, 16 FCC Rcd at 11257, para. 27 As the Fifth Circuit explained, "[b]ecause universal service is funded by a general pool subsidized by all telecommunications providers – and thus indirectly (continued....)

contributors is inherent in the principle of sufficiency.[127] For these reasons, we disagree with commenters who claim that we should not consider the size of the fund in determining how much support should be provided.[128] We also disagree with commenters who urge us to adopt a separate principle under section 254(b)(7) to consider the burdens on contributors in determining sufficiency.[129]

38. In response to the Tenth Circuit's remand, we also adopt a more precise definition of "reasonably comparable" rural and urban rates for purposes of assessing the sufficiency of the non-rural high-cost support mechanism. Specifically, for purposes of the non-rural mechanism, rates in rural areas will be presumed to be "reasonably comparable" to urban rates if they deviate no further than two standard deviations above the national average urban rate in the Bureau's *Reference Book*.[130] This definition of "reasonably comparable" rural and urban rates is derived from the recommendation of the Joint Board that we establish a national urban rate benchmark based on the available rate data in the Bureau's *Reference Book*. Although the Joint Board did not explicitly define "reasonably comparable," it recommended that the Commission establish a "safe harbor" whereby a state whose rates in rural, high-cost areas served by non-rural carriers are at or below the national urban rate benchmark may certify that its rural rates in areas served by non-rural carriers are reasonably comparable to urban rates nationwide.[131] We emphasize that the definition of "reasonably comparable" we adopt establishes a presumption only.[132] As discussed below in part IV.D.2, factors other than basic rates may affect rate comparability, and states will have the opportunity to provide additional information rebutting the presumption established by the definition.[133]

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by customers – excess subsidization in some cases may detract from universal service by causing rates unnecessarily to rise, thereby pricing some consumers out of the market." *Alenco Communications, In v. FCC*, 201 F.3d 608, 619 (5th Cir. 2000).

[127] The Tenth Circuit suggested that excessive subsidization arguably may violate the affordability principle in section 254(b)(1). *Qwest*, 258 F.3d at 1200.

[128] *See, e g*, Montana and Vermont Comments at 5; SBC Reply Comments at 13-15.

[129] AT&T argues ~~that we should adopt an~~ explicit principle, ~~pursuant to section~~ 254(b)(7)~~, stating that the burden~~ on contributors to universal service should be minimized. *See* AT&T Comments at 11-12.

[130] *See 2003 Reference Book* The Bureau's *Reference Book* includes an annual survey of local telephone rates in 95 cities that the Bureau has conducted for the past 17 years. As discussed below, based on the most recent Bureau data, the rate benchmark level presently is $32.28, or 138% of the national average urban rate. *See infra* para. 41; part IV.D.2.

[131] Several commenters interpret the Joint Board's recommendation as a definition of reasonably comparable rates. *See e g.*, NASUCA Comments at 6-8; *but see* Sprint Comments at 5 ("[T]he Joint Board's recommendation does not define reasonably comparable rates, but merely provides a conclusion of same . . .")

[132] The Joint Board emphasized that the rate benchmark is meant simply as a "safe harbor." *See Recommended Decision*, 17 FCC Rcd at 20738, para. 53.

[133] For example, a state could show that due to other factors, such as additional services included in the basic service rate, its rates should be considered to be reasonably comparable even though they are above the benchmark. Alternatively, a state could show that its rates should not be considered to be reasonably comparable (continued.. .)

39. We conclude that the range of variability of urban rates is an appropriate measure of what should be considered reasonably comparable rural and urban rates for purposes of assessing the sufficiency of non-rural high-cost support. We agree with the Joint Board that Congress, in seeking to preserve universal service, considered rural and urban rates to be reasonably comparable in 1996.[134] If Congress had determined that rates were not reasonably comparable at the time of the Act, it would have explicitly directed the Commission and the states to alter the existing intrastate rate structure.[135] Instead, Congress specifically preserved state authority and flexibility in setting intrastate rates.[136] We also note that Congress used the words "preservation" and "preserve" in the 1996 Act, indicating its view that the universal service mechanisms that pre-dated the 1996 Act adequately promoted universal service.[137] We do not believe that our reading of the statute is undermined by the fact that section 254 is designed to advance, as well as preserve, universal service. We find that the goal of advancing universal service is consistent with our understanding that our universal service rules should evolve as markets and technology change.[138]

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even though they are below the benchmark, because, for example, the services included in its basic rate are not comparable to services in other states or the calling scopes are significantly different.

[134] *See Recommended Decision*, 17 FCC Rcd at 20729, para. 35 & n.88; AT&T Comments at 8; Verizon Comments at 8. As discussed herein, we are not persuaded by commenters who argue that the 1996 Act required the Commission to require or induce all states to immediately remove implicit subsidies and rebalance rates. *See supra* para. 26; *infra* para. 77, *see also, e.g* , Qwest Comments at 7; SBC Comments at 1-2, 24. Nor do we agree that we should establish a rate floor. *See* Sprint Comments at 4.

[135] *See* AT&T Comments at 9.

[136] *See* S. Conf. Rep. No. 230, 104th Cong., 2nd Sess. 232. ("State authority with respect to universal service is specifically preserved under new section 254(f)."), *see also* 47 U.S.C. §152(b).

[137] *See* 47 U.S C. § 254(b) ("The Joint Board and the Commission shall base policies for the preservation and advancement of universal service on the following principles."); 47 U.S.C. § 254(b)(5) ("There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service."). During the Senate debate, Senator Pressler, the Chairman of the Committee on Commerce, Science, and Transportation (Commerce Committee), stated that "the need to preserve widely available and reasonably priced services is a fundamental concern addressed" in the legislation. 141 Cong. Rec. S7893 (June 7, 1995). "To smaller cities and rural communities and others who depend upon universal service," Senator Pressler said, "nothing is changed. They continue to enjoy affordable access to phone service as before." 141 Cong. Rec. S7893-94 (June 7, 1995). After calling universal service the most important objective and criticizing airline deregulation, Senator Hollings, Ranking Member of the Commerce Committee, said he wanted to make sure that deregulation did not "mess up . . the wonderful telecommunications service that we have had." 141 Cong. Rec. S7894 (June 7, 1995). Senator Hollings said that "[s]pecial provisions in the legislation address universal service in rural areas to guarantee that harm to universal service is avoided there." 141 Cong. Rec. S7895 (June 7, 1995). Senator Stevens, a key sponsor of the universal service provisions, said that the "concept [of universal service] is preserved in [the legislation] in a new manner It opens up the local market to competition while still preserving the concept of universal service." 141 Cong. Rec. S7900 (June 7, 1995)

[138] Section 254 explicitly defines universal service as an "evolving level of telecommunications services" to take into account advances in telecommunications and information technology. 47 U.S.C. § 254(c); *see also* S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 131

40. In considering what Congress meant by reasonably comparable rates, therefore, we find it reasonable to assume that Congress was well aware that local rates varied from state to state, in large part because states base rates on a variety of different policies, in addition to cost.[139] Although we do not have readily available rural rate data from that period, we know from the Bureau's annual rate survey that, at the time of the 1996 Act, urban residential rates ranged from $13.04 to $30.62 and the average urban rate was $20.01 in the ninety-five cities surveyed.[140] The highest urban rate in the survey was 234 percent of the lowest urban rate and 153 percent of the average urban rate.[141] We find it reasonable to assume that Congress was aware of the variability of urban rates when it enacted the 1996 Act. We do not believe that Congress would have required rural rates to be any closer to the average urban rate than other urban rates.

41. We also find that the measure of reasonable comparability should be adjusted every year based on actual rate data, rather than set at a fixed percentage.[142] By adjusting the rate benchmark each year, our reasonable comparability standard will reflect changes in urban rates as the marketplace changes. Since passage of the 1996 Act, residential urban rates have increased somewhat but the range of rates has remained approximately the same. In 2002, surveyed residential urban rates ranged from $15.65 to $35.19.[143] The highest urban rate in the *Reference Book* is 225 percent of the lowest urban rate and 151 percent of the average urban rate ($23.38).[144] As explained below in part IV.D.2.a., we find that it is appropriate to use standard deviation analysis, rather than the range of rates in the *Reference Book*, to set the urban rate benchmark, because the standard deviation measures the dispersion from the average, thereby reflecting both the average urban rate and the variation of urban rates.[145] We also find below that setting the urban rate benchmark at the average urban rate in the *Reference Book* plus two standard deviations best serves the rate benchmark's intended purpose as a safe harbor, because it will require that states more closely scrutinize rural rates that approach the highest urban rates.[146] Based on the most recent Bureau data, an urban rate benchmark of two standard

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[139] Under the high-cost support mechanisms in place in 1996, the non-rural companies received support if their average loop costs exceeded the national average loop cost by certain cost benchmarks. *See supra* notes 71, 84. *See also Recommended Decision*, 17 FCC Rcd at 20729, para. 35 & n.88.

[140] These rates are as of October 1, 1995. Because the Senate and House considered and passed telecommunications legislation in 1995 and adopted the 1996 Act in February 1996, these rates are closer in time to Congress' deliberations that the rates surveyed for 1996. As of October 1, 1996, residential urban rates ranged from $13.04 to $28 65, and the highest urban rate was 220 percent of the lowest urban rate and 144 percent of the average urban residential rate ($19.95). *See 2003 Reference Book* at Tables 1.2, 1.4; *infra* Appendix B.

[141] *See 2003 Reference Book* at Tables 1.2, 1.4, *infra* Appendix B.

[142] The Joint Board suggested that it might be appropriate to use 135% for the safe harbor benchmark. *See Recommended Decision*, 17 FCC Rcd at 20740, para. 52.

[143] *See 2003 Reference Book* at Table 1.3; *infra* Appendix B.

[144] *2003 Reference Book* at Tables 1.1, 1 3, *infra* Appendix B

[145] *See infra* para. 80.

[146] *See infra* para 81

deviations above the national average urban rate is $32.28, or 138 percent of the nationwide average urban rate.

42. The definition of reasonably comparable rates we adopt today is primarily designed to permit us to compare relevant rates among states and to assess whether the non-rural mechanism provides sufficient support to enable high-cost states to achieve reasonably comparable rates. We find that our definition is consistent with the purpose of federal support under the non-rural mechanism. As discussed in detail above, the non-rural mechanism identifies and provides support to non-rural carriers in high-cost states. While most states have the resources to ensure reasonably comparable rates within their borders, high-cost states likely could not achieve rural rates comparable to urban rates in most other states without federal support.

43. We disagree with commenters who argue that a national urban rate benchmark cannot adequately define reasonably comparable rates because it does not compare rural and urban rates within states.[147] Currently, the range of variability of rural and urban rates within most states, based on the data in the GAO Report, is narrower than the range of variability of urban rates among states in the Bureau's *Reference Book*.[148] In addition, in most states the rates are generally within the range of nationwide urban rates. Thus, in most cases, a state's successful efforts to maintain rural rates below the rate benchmark would also result in rural and urban rates within the state that differ no more than urban rates nationwide.[149] Therefore, the national urban rate benchmark provides an adequate measure for comparing rural and urban rates at this time.

44. We find no support in the language of the Act, its legislative history, or in the actual rate data in the record to support the claim that "a 25% difference is the outer limit of being 'reasonably comparable'."[150] As set forth above, urban rates themselves varied more widely at the time of the 1996 Act and vary more widely today. A benchmark of 25 percent above the average urban rate would require rural rates to be closer to the average urban rate than other urban rates. As discussed above, we do not believe Congress would have required such a

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[147] *See* Surewest Comments at 6-10. ~~The national urban rate benchmark does not directly address the~~ relationship to each other of rural and urban rates within a state that are below the benchmark. Urban and rural rates within a state may diverge significantly. For example, Surewest asserts that in California, Roseville's average monthly basic residential service rate is $31.24 and SBC's in a neighboring jurisdiction is $10.69. We note that, for reasons described above, we do not agree with Surewest that such a rate discrepancy represents a problem of insufficient federal support. *See supra* paras. 21-22.

[148] *See* GAO Report at Appendix IV.

[149] If a state were not able to maintain rural rates below the rate benchmark, it would be required to provide additional information to us, as discussed below in part IV.D. Rate comparisons within the state would then be useful in assessing the reason for the high rural rates. For example, if the states' urban rates were also above the benchmark, it may be that the federal support mechanism should be adjusted. If, on the other hand, the state's urban rates were much lower than its rural rates, the state should have the resources to lower its rural rates without additional support.

[150] *See* Maine Comments at 23.

result.[151] The *Qwest* court suggested that a discrepancy between rural and urban rates of 70 to 80 percent would not be considered to be reasonably comparable.[152] Based on our analysis of the relevant data, we believe that the rate benchmark we adopt in this Order, currently 38 percent above the nationwide average urban rate, is likely to remain well below 70 or 80 percent. Between 1993 and 2002, the nationwide average urban rate plus two standard deviations ranged from 133 percent to 143 percent above the average urban rate.[153] Although the court did not specify whether it was considering the relationship of the maximum to the average or to the floor when it addressed whether a 70 or 80 percent discrepancy would be reasonably comparable, we think that it is appropriate to measure the divergence from the average rate for purposes of interpreting section 254(b)(3). The average urban rate is more representative of urban rates nationwide than any single urban rate in the *Reference Book*. Measuring divergence from the lowest urban rate could be too heavily influenced by a particular state's rate policies. Measuring divergence from the national average urban rate more accurately captures the variability of rate polices among the states, and is, therefore, more consistent with the purposes of the non-rural mechanism.[154]

45. We are not persuaded by SBC that the Commission should establish an affordability benchmark for local telephone service based on the median household income of a particular geographic area.[155] While the Joint Board and the Commission generally have considered affordability in implementing section 254, the Commission has not specifically identified an affordable rate, and we decline to do so now.[156] Because various factors, many of which are local in nature, affect rate affordability, the Commission agreed with the Joint Board that it would not be appropriate to establish a nationwide affordable rate.[157] The Commission also agreed with the Joint Board that states should exercise primary responsibility for

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[151] *See supra* para. 40.

[152] *Qwest v. FCC*, 258 F.3d at 1201. Intervenors' assertion before the Tenth Circuit that some rural rates could be 70-80% higher than urban rates under the non-rural mechanism was based on their claim that *costs* were 70-80% higher in rural areas than in urban areas. Intervenors submitted cost data, but not rate data, to the court Accordingly, the court's statement actually was based on *cost* rather than rate data

[153] *See infra* Appendix B.

[154] As discussed below, the definition of reasonably comparable rates is primarily designed to evaluate the comparability of rates among states. In most cases, it will also effectively measure comparability of rates within states, because rural and urban rates in most states vary less than urban rates vary among states nationwide. In some cases, however, if urban rates in a state were very low, rural rates could be below the benchmark but further from the urban rates in that state than they are from the nationwide urban rate. Surewest, for example, argues that Roseville's residential rates are 85% higher than SBC's rates in California. *See* Surewest Comments at 8-9. We note that Roseville's rate of $31.24 is below the benchmark we adopt, currently $32.28.

[155] *See* SBC Comments at 15.

[156] *See, e.g., First Recommended Decision*, 12 FCC Rcd at 150-54, paras 125-133; *First Report and Order*, 12 FCC Rcd at 8837-46, paras 108-26; *Seventh Report and Order*, 14 FCC Rcd at 8095-97, paras. 36-40

[157] *See First Report and Order*, 12 FCC Rcd at 8842, para. 118; *see also First Recommended Decision*, 12 FCC Rcd at 153, para 131

determining the affordability of rates.[158] The Commission previously rejected a proposal similar to the one SBC suggests now, concluding that it "would over-emphasize income levels in relation to other non-rate factors that may affect affordability and fail to reflect the effect of local circumstances on the affordability of a particular rate."[159] Given the unique characteristics of each jurisdiction, we continue to find that states are better suited than the Commission to make determinations regarding affordability.[160] Moreover, the Commission has previously rejected a proposal to link non-rural high-cost support to income and stated that "section 254(b)(3) reflects a legislative judgment that all Americans, regardless of income, should have access to the network at reasonably comparable rates."[161]

46. We disagree with some commenting states that, because non-rural high-cost support is based on costs, "reasonably comparable" must also be defined in terms of costs, not rates.[162] Specifically, they claim that the Commission must provide a standard to measure whether cost levels net of support in rural areas are reasonably comparable to those in urban areas.[163] Two states argue that "[i]f 'rates equal costs' for support, then 'rates equal costs' for accountability."[164] First, the court emphasized that the Act speaks in terms of reasonable comparability of rates, not costs.[165] Furthermore, rates do not "equal" costs for purposes of non-rural high-cost support.[166] Costs can be used as a "proxy" for rates only in a general sense.[167]

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[158] *See First Report and Order*, 12 FCC Rcd at 8837, 8842, paras. 108, 118; *see also First Recommended Decision*, 12 FCC Rcd at 154, para. 131.

[159] *See First Report and Order*, 12 FCC Rcd at 8841, para. 115.

[160] *See id* at 8842, para. 118; *Seventh Report and Order*, 14 FCC Rcd at 8096, para. 38.

[161] *See Seventh Report and Order*, 14 FCC Rcd at 8097, para. 39.

[162] *See* Maine Comments at 6-8; Montana and Vermont Comments at 4-5, 26-29

[163] *See* Maine Comments at 8; Montana and Vermont Comments at 26

[164] *See* Montana and Vermont Comments at 30.

[165] *See Qwest*, 258 F.3d at 1201 (Commission's cost-based definitions of "reasonably comparable" are not reasonable interpretations of the statutory language because "[t]he Act calls for reasonable comparability between rural and urban rates; these definitions simply substitute different standards."). *See also Recommended Decision*, 17 FCC Rcd at 20729, para. 34; *supra* note 21 ("As the court observed, although non-rural high-cost support is distributed based on a comparison of national and statewide average costs, the benchmark must be ultimately based on attainment of the statutory principle of reasonable comparability of urban and rural rates.").

[166] As noted earlier, the rate benchmark we adopt here for purposes of defining "reasonable comparability" has a different purpose than the cost benchmark we discuss below in part IV.C The cost benchmark is used to measure the amount of federal high-cost support non-rural carriers in each state may receive, and it is set at a level intended to ensure that all states have relatively equal abilities to achieve rate comparability in light of their resources based on average costs. The rate benchmark we adopt here will be used to gauge the success of combined federal and state efforts to ensure rate comparability by measuring whether individual rural rates are reasonably comparable to nationwide urban rates.

[167] For example, a state may permit carriers to recover part of the cost of providing a particular service, such as residential telephone service, from revenues received for other services, such as call waiting, caller ID, or (continued...)

Rather, as discussed above, cost differences represent the best measure of the resources each state can bring to bear in exercising its primary responsibility for achieving local rate comparability, in light of the Act's dual regulatory structure.[168] Moreover, the approach advocated by these parties would fundamentally disregard the court's mandate that we induce states to establish reasonably comparable rates. Essentially, they maintain that "reasonably comparable" must be defined in terms of cost because the federal role is limited to providing support to high-cost states, and the Commission cannot encourage or induce state action to ensure rate comparability.[169] This is precisely what the court found was required of the Commission under the Act, however.[170]

47. We also reject NASUCA's argument that the definition of reasonable comparability recommended by the Joint Board places too much emphasis on costs and rates, and should emphasize service quality issues, such as local calling areas, as well.[171] While we agree with NASUCA that service quality is an important goal, we believe that states are in the best position to address service quality issues and will have ample opportunity to do so in the rate review and expanded certification process discussed in part IV.D. below. In the *First Report and Order*, consistent with the Joint Board's recommendations, the Commission concluded that federally-imposed service quality or technical standards were not required at the time.[172] Because most states had established mechanisms designed to ensure service quality in their jurisdictions, the Commission found that additional efforts undertaken at the federal level would be largely redundant.[173]

48. We conclude that our definition of reasonably comparable rates, combined with the rate review process we adopt below, will allow us "to assess whether [the FCC's] funding mechanism will be sufficient for the principle of making rural and urban rates reasonably comparable," as required by the court.[174] We find that this definition responds to the court's

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intrastate toll services. In particular, the cost of serving a high-cost wire center is not likely be a good proxy for rates in that specific area. To keep rates from being prohibitively high in high-cost areas, states generally require below-cost rates in high-cost areas and permit the carrier to recover some of these costs with above-cost rates in other areas. *See supra* para. 15.

[168] *See supra* para. 23

[169] Montana and Vermont argue that the Commission cannot condition federal support on a state's certification that is has established reasonably comparable rates in rural and urban areas within its borders. They claim in a hypothetical example that a state with $100 rural rates and $10 urban rates "deserves" federal support as much as states that have equalized rural and urban rates by either rate averaging or explicit support. *See* Montana and Vermont Comments at 36-37.

[170] *See Qwest v FCC*, 258 F.3d at 1202.

[171] *See* NASUCA Comments at 7.

[172] *First Report and Order*, 12 FCC Rcd at 8831, para. 98.

[173] *Id* at 8833, para 101

[174] *Qwest v FCC*, 258 F.3d at 1202; *see infra* part IV D.

criticism of the Commission's previous definitions of "reasonably comparable" for failing to "help answer the questions that arise about reasonable comparability."[175] We also find that the rate review and expanded certification process responds to the court's admonition that section 254 "requires a comparison of rural and urban areas, not states."[176] Rates in rural areas served by non-rural carriers can easily be compared to the national urban rate benchmark to determine whether or not a state's rural rates are presumed to be reasonably comparable to urban rates nationwide. As discussed in detail below, states will be required to certify that their non-rural company rates in high-cost areas are reasonably comparable to a national urban rate benchmark or explain why they are not.[177] This process will allow the Commission to better assess whether or not the non-rural mechanism is achieving its goal of ensuring reasonably comparable rural and urban rates and will induce states to maintain and ensure rural and urban rate comparability as competition develops and market conditions change.

C. Cost Benchmark

49. We modify the non-rural mechanism by changing the cost benchmark to one based on two standard deviations above the national average cost per line. The cost benchmark is used to determine the amount of non-rural high-cost support that non-rural carriers in each state will receive.[178] As discussed below, modifying the benchmark ties it more directly to the relevant data, consistent with the court's directive, but does not alter the level of non-rural support in a major way. We agree with the Joint Board that the current benchmark level is supported by data from the GAO Report indicating that rural and urban rates generally are reasonably comparable today. In our analysis of the data in the GAO Report, we apply the definition of reasonably comparable rural and urban rates adopted in this Order. We also agree with the Joint Board that standard deviation analysis of the relevant cost data supports the current level of non-rural support. Based on our examination of the record, we find that a two-standard-deviation threshold provides sufficient non-rural high-cost support to achieve the statutory principle of making urban and rural rates reasonably comparable. We further conclude that setting the cost benchmark based on two standard deviations would address changes in the dispersion of statewide average costs per line more directly than the current 135 percent benchmark.

1. Background

50. In the *Ninth Report and Order*, the Commission set the cost benchmark for the non-rural high-cost support mechanism at 135 percent of the national average cost per line.[179] If

[175] *Qwest v FCC*, 258 F.3d at 1201.

[176] *Id* at 1204.

[177] *See infra* part IV.D.2.

[178] The urban rate benchmark adopted in this Order, in contrast, will be used to gauge the success of combined federal and state efforts to ensure rate comparability by measuring whether individual rural rates are reasonably comparable to nationwide urban rates.

[179] *Ninth Report and Order*, 14 FCC Rcd at 20463-6, paras. 55-59.

the statewide average cost per line for non-rural carriers, as calculated by the cost model, exceeds the benchmark, then the non-rural mechanism provides support for intrastate costs in excess of the benchmark.[180] The Commission stated several reasons for setting the benchmark at 135 percent of the national average cost per line. A benchmark of 135 percent, the Commission reasoned, "falls within the range recommended by the Joint Board" of 115 to 150 percent of the national average cost per line.[181] The Commission also stated that a 135 percent benchmark was "consistent with the precedent of the existing support mechanism[.]"[182] In addition, the Commission found that the 135 percent benchmark was a "reasonable compromise of commenters' proposals[,]" which ranged from 80 to 200 percent of the nationwide average.[183] The Commission further stated that "a national benchmark of 135 percent strikes a fair balance between the federal mechanism's responsibility to enable reasonable comparability of rates among states and the burden placed on below-benchmark states (and ratepayers) whose contributions fund the federal support mechanism."[184]

51. In *Qwest*, the court found that the Commission's justifications in the *Ninth Report and Order* failed to adequately support the choice of a 135 percent national average cost benchmark, stating that the Commission's duty is not to "pick the 'midpoint' or come to a 'reasonable compromise' among competing positions."[185] Rather, the Commission must "make rational and informed decisions on the record before it in order to achieve the principles set by Congress."[186] Nonetheless, the court recognized that the "determination of a benchmark will

[180] *Id* at 20467, para. 63. The non-rural high-cost support mechanism provides support for 76 percent of statewide average costs that are above the national benchmark. The mechanism calculates support based on 75 percent of forward-looking loop costs and 85 percent of forward-looking port costs, as well as 100 percent of all other forward-looking costs determined by the cost model. The percentage of forward-looking costs that the intrastate portion of each of the items represents is equivalent to 76 percent of total forward-looking costs. *Id.*

[181] *Id* at 20464, para 55. *See also Second Recommended Decision*, 13 FCC Rcd at 24761-2, para. 43.

[182] *Ninth Report and Order*, 14 Rcd at 20464, para. 55. Prior to the *Ninth Report and Order*, both rural and non-rural carriers were eligible for federal support under the Commission's high-cost loop support mechanism. That mechanism provides gradually more support for costs that exceed certain thresholds or "steps" above the national average based on carriers' loop costs, as reflected in their books. *Id* at 20440, para. 13. The Commission explained in the *Ninth Report and Order* that the 135 percent benchmark was "near the midpoint of the range" of the high-cost loop support mechanism, which "begins providing support for costs between 115 and 160 percent of the national average cost per line, ... and the vast majority of non-rural carriers receive all their current support for costs in this range." *Id* at 20464, para. 55.

[183] *Id* at 20464, para. 55.

[184] *Id* at 20465, para. 58; see *Seventh Report and Order*, 14 FCC Rcd at 8102, 8112, para. 48 and 70 ("Given that telephone service currently is largely affordable, and any significant increase in the size of federal support for local rates appears unnecessary, we conclude that we should limit the size of the federal mechanism, as recommended by the Joint Board.")(citation omitted).

[185] *Qwest*, 258 F.3d at 1202.

[186] *Id*